

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF TENNESSEE

In re:

No. 96-14804
Chapter 7

JAMES ARNOLD ELLIOTT
DELORES LEE ELLIOTT,
d/b/a Southern Metal Fabrication

Debtors

SUPREME BUILDING PRODUCTS, INC.

Plaintiff

v

Adversary Proceeding
No. 97-1007

EQUITY PROGRAMMERS, INC.

Defendant/Third Party Plaintiff

v

THE CITY BANK & TRUST CO.,

Third Party Defendant

MEMORANDUM

Appearances: William T. Ramsey and W. David Bridgers, Neal & Harwell, P.C.,
Nashville, Tennessee, Attorneys for Supreme Building Products, Inc.

Janet Meredith Songer, Edwards & Songer, Winchester, Tennessee,
Attorney for Equity Programmers, Inc.

B. Timothy Pirtle, McMinnville, Tennessee, Attorney for The City Bank
& Trust Company

Harold Fisher, Harrison & Fisher, Manchester, Tennessee, Attorney
for Debtors

This adversary proceeding arises out of the voluntary Chapter 7 case of James and Delores Elliott (“the debtors”).

Before the debtors’ bankruptcy, they mortgaged certain real property to Supreme Building Products, Inc. (“SBP”) and to City Bank and Trust (“City Bank”). City Bank assigned its mortgage to Equity Programmers, Inc. (“EPI”). SBP commenced this adversary proceeding against EPI to determine on which mortgage has priority over the other. EPI filed a third party complaint against City Bank.

There are now three motions pending in this proceeding. City Bank filed a motion to dismiss or abstain as to EPI’s third party complaint against it. SBP filed a motion for summary judgment against EPI. EPI filed a motion for abstention or an extension of the time to respond to the motion for summary judgment filed by SBP.

The record up to this point reveals the following allegations:

- (1) City Bank executed and recorded a release of the mortgage to SBP;
- (2) City Bank obtained and recorded its own mortgage on the same property;
- (3) City Bank re-recorded the mortgage to SBP;
- (4) SBP recorded an instrument of correction, which apparently was an attempt to negate the release recorded by City Bank;
- (5) City Bank assigned its mortgage to EPI;
- (6) EPI took the assignment in reliance on the representations by City Bank that the mortgage had first priority;

(7) the debtors defaulted on the mortgage, and EPI began foreclosure, but the foreclosure was stopped by the debtors' bankruptcy;

(8) SBP and EPI have filed claims in the debtors' bankruptcy case;

(9) the property does not have sufficient value to pay the mortgage debts to EPI and SBP.

SBP contends its mortgage should have priority over the EPI mortgage. Of course, EPI denies there is any reason to give priority to the SBP mortgage. EPI also asserts that City Bank should be liable to it for any loss that results if the court rules in favor of SBP as to the priority of the mortgages.

The court takes judicial notice of certain facts revealed by the file in the bankruptcy case. *Fed. R. Evid. 201*; Barry Russell, *Bankruptcy Evidence Manual* §§ 201.5 & 201.6 (1997). The debtors filed bankruptcy under Chapter 7, a bankruptcy trustee was appointed, and the trustee has abandoned the property subject to the mortgages.

The trustee's abandonment does not necessarily mean the court lacks subject matter jurisdiction to decide which mortgage has priority. According to the allegations, the creditor whose mortgage is second in priority will not be paid in full by foreclosure, and as a result, will have an unsecured claim in the debtors' bankruptcy case. Assuming this is true, the priority dispute will determine whether SBP or EPI has an unsecured claim.

The court need not decide this kind of dispute in a no-asset bankruptcy case. If there is to be no payment on unsecured claims, the trustee can completely administer the bankruptcy case without knowing which creditor has the unsecured claim. In this case, however, there may be a dividend on unsecured claims. In this regard, the court again takes judicial notice of facts revealed by the file in the bankruptcy case. *Fed. R. Evid.* 201; Barry Russell, *Bankruptcy Evidence Manual* §§ 201.5 & 201.6 (1997). The original no-asset notice to creditors directed them not to file proofs of claims. Subsequently, the trustee settled a dispute with the debtors in return for payment of \$2,000 and sold property for \$17,000, less an auctioneer's commission. At the trustee's request, the clerk sent a notice to creditors that there might be assets, and that they should file proofs of claims within 90 days after the date of the notice.

It appears the court has jurisdiction to determine the priority dispute. *Equimark Commercial Finance Co. v. First National Bank (In re Showcase Natural Casing Co.)*, 54 B.R. 138 (Bankr. S. D. Ohio 1984); *In re Jodan's Pro Hardware*, 49 B.R. 976 (Bankr. E. D. Wis. 1985); see also *Lindsey v. O'Brien, Tanski, Tanzer and Young Health Care Providers (In re Dow Corning Corp.)*, 86 F.3d 482 (6th Cir. 1996); *Sanders Confectionery Products, Inc. v. Heller Financial Inc.*, 973 F.2d 474 (6th Cir. 1992) *cert. den.* 506 U.S. 1079, 113 S.Ct. 1046, 122 L.Ed.2d 355 (1993), *reh. den.*, 507 U.S. 1002, 113 S.Ct. 1628, 123 L.Ed.2d 186 (1993); but see *Cullen Electric Co. v. Bill Cullen Electrical Contracting Co. (In re Bill Cullen Electrical Contracting Co.)*, 160 B.R. 581 (Bankr. N. D. Ill. 1993).

The court, however, still may abstain. A majority of courts hold that mandatory abstention applies only if a pending state court action involving the same issues has been commenced at least before the filing of the motion for abstention. 28 U.S.C. § 1334(c)(2). *Sapir v. Hudson Realty Co. (In re Rosalind Gardens Associates)*, 158 B.R. 15, 18 (S. D. N. Y. 1993); *Flores v. Telemundo Group*, 133 B.R. 674, 676 (D. P. R. 1991); *Container Transport, Inc. v. Scott Paper Co. (In re Container Transport, Inc.)*, 86 B.R. 804, 806 (E. D. Pa. 1988); *Hackeling v. Rael Automatic Sprinkler Co. (In re Luis Electrical Contracting Corp.)*, 165 B.R. 358, 366 (Bankr. E. D. N. Y. 1992); *West Coast Video Enterprises, Inc. v. Owens (In re West Coast Video Enterprises, Inc.)*, 145 B.R. 484 (Bankr. E. D. Pa. 1992); *Nationwide Roofing & Sheet Metal, Inc. v. Cincinnati Ins. Co. (In re Nationwide Roofing & Sheet Metal, Inc.)*, 130 B.R. 768, 778-779 (Bankr. S. D. Ohio 1991); *Southwinds Associates Ltd. v. Reedy (In re Southwinds Associates Ltd.)*, 115 B.R. 857 (Bankr. W. D. Pa. 1990). Because the evidence does not show there is a pending state court action, mandatory abstention does not apply.

The motion by EPI does not request discretionary abstention, but the court can raise the issue itself, without a motion by a party. Compare 11 U.S.C. § 1334(c)(1) and (c)(2); *Clayter v. Larkin (In re Clayter)*, 174 B.R. 134, 141-142 (Bankr. D. Kan. 1994). Discretionary abstention may apply. The statute allows the court to abstain in the interest of justice, or in the interest of comity with state courts or respect for state law. 28 U.S.C. § 1334(c)(1).

The priority dispute between SBP and EPI is purely a matter of Tennessee law. The administration of the bankruptcy estate does not require the court to determine EPI's claim against City Bank. Indeed, the court's jurisdiction of the third party complaint is doubtful. If EPI loses the priority dispute but prevails against and recovers from City Bank, then City Bank may be subrogated to EPI's unsecured claim in the bankruptcy case. The court doubts that this possibility makes the third party complaint a proceeding arising in or related to the bankruptcy case. 28 U.S.C. § 1334(b); *Feld v. Zale Corp. (In re Zale Corp.)*, 62 F.3d 746, 751-757 (5th Cir. 1995); *Adams v. Prudential Securities, Inc. (In re Foundation for New Era Philanthropy)*, 201 B.R. 382, 385-397 (Bankr. E. D. Pa. 1996); *First Midwest Bank v. St. Paul Ins. Co. (In re First Metropolitan Financial Corp.)*, 1993 WL 22173 (Bankr. N. D. Ill. Jan. 29, 1993). This reasoning is not contrary to the Sixth Circuit's decision in *Lindsey*; it involved third parties that may have been jointly liable with the debtor and joint insurance. *Lindsey v. O'Brien, Tanski, Tanzer and Young Health Care Providers (In re Dow Corning Corp.)*, 86 F.3d 482, 488-495 (6th Cir. 1996); see also *Feld v. Zale Corp. (In re Zale Corp.)*, 62 F.3d 746, 755, n. 24 (5th Cir. 1995).

Thus, the court may be able to try the priority dispute but not the third party complaint. This could force the parties to try some of the facts twice, once in this court and again in another court. In particular, there may be some overlap in the evidence regarding the priority dispute and EPI's claim against City Bank, especially with regard to City Bank's release of the SBP mortgage. A state court can deal with both the priority dispute and EPI's claim against City Bank.

Finally, the trustee may be able to complete the administration of the estate, including the payment of a dividend, without a final decision on the priority dispute. *In re Jodan's Pro Hardware*, 49 B.R. 976 (Bankr. E. D. Wis. 1985); *Atamian Manufacturing Corp. v. Citizens Trust Co. (In re E. A. Adams, Inc.)*, 29 B.R. 224, 226, n. 4 (Bankr. D. R. I. 1983). In this regard, the court takes judicial notice that the Internal Revenue Service has filed a priority claim for almost \$57,000, and the trustee is holding less than \$20,000. *Fed. R. Evid.* 201; Barry Russell, *Bankruptcy Evidence Manual* §§ 201.5 & 201.6 (1997). There may be no need to decide which of these creditors has a non-priority unsecured claim.

Notwithstanding the possible effect on the administration of the bankruptcy case, the court is inclined to abstain and let this dispute be tried in state court. Abstention affords the parties an opportunity to resolve this dispute in one forum. The court will enter an order accordingly.

This Memorandum constitutes findings of fact and conclusions of law as required by Fed. R. Bankr. P. 7052.

BY THE COURT

entered 9/10/1997

R. THOMAS STINNETT
UNITED STATES BANKRUPTCY JUDGE